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Supreme Court of the United States

OCTOBER TERM, 1961

No. [illegible]

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,
Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,
Respondents.

IN THE MATTER
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,
Debtor.

BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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No. 739.

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

IN THE MATTER

of

NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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Questions Presented.

No. 26362

Does §249 of the Bankruptcy Act, which denies compensation to applicants for an allowance who have traded in the shares of a Chapter X Debtor, apply to an officer and employee who were not applicants for an allowance but who had been continued in the employ of the Debtor-in-Possession by orders of the Bankruptcy Court under §§189 and 191 on a weekly salary basis?

The Court of Appeals held §249 inapplicable.

No. 27000

Where a promoter, without assets of his own, had collected funds for investment in a fair grounds and market enterprise, and none of the money had actually reached the corporation that was to operate it, but the promoter had used a portion thereof for the acquisition of the property by the corporation, and had distributed stock certificates on an original issue basis to the investors and to others, did the Court of Appeals in a Chapter X Proceeding correctly hold that the stock claimants who entrusted their money to the promoter for investment in the market property should be recognized as stockholders in the proportion of their respective contributions, and that those who received certificates in payment of, or as security for the promoter's own debts arising from unrelated transactions should not be recognized as stockholders?

PROPOSED SEVERANCE FROM MANAGEMENT AND DENIAL OF SALARY TO OFFICER AND SUPERVISORY EMPLOYEE.

[No. 26362]

Statement.

The facts are stated in the opinion of the Court below by Friendly, J. [Appendix B, 49a-51a].

In sum, Weinstein had been president and Fried manager of the Debtor prior to the filing of the Chapter X petition. After approval of the petition, Weinstein was continued at $50 a week by an order granted under §191 of the Bankruptcy Act. Fried was also employed by the Court's authority under the mistaken impression that he was an officer, "secretary-treasurer". Concededly, he was not. Successive orders increased his salary to $200 a week. On June 14, 1960, the District Court severed Weinstein and Fried from the Debtor's employ and denied them any further compensation for the reason that each of them had purchased and sold a few shares of the Debtor's stock during the Chapter X Proceeding.

The controversy whether there was due from the race track corporation controlled by Fried more rent than had actually been paid the Debtor has no place in this case. As the Court of Appeals noted [Appendix B, 51a], the District Court separated Weinstein and Fried from the management of the Debtor "solely because they, as fiduciaries, violated section 249 of the Bankruptcy Act by dealing in the Debtor's stock." No other question was passed on by the District Court, and the review of the Court of Appeals was necessarily limited to that question.

Reasons for Denying Certiorari.

The Court of Appeals properly held that §249 of the Bankruptcy Act did not apply to salaried personnel such as Weinstein and Fried.

Article VIII of Chapter X of the Bankruptcy Act deals with the titles, rights and powers of trustees and debtors in possession. It was under §191 of this article that Weinstein and Fried were continued in employ at a salary. Article XIII deals with compensation and allowances, and it is in this article that §249, relating to stock-trading, is found. The Court of Appeals held that that section relates only to applications for allowances covered by the prior sections of Article XIII, that it does not apply to persons employed on a salary basis under a section found in Article VIII.

Petitioners argue from a plane of high principle, as if §249 were but a codification of a general proposition of law. There is no such general proposition. *Securities Commission* v. *Chenery Corporation* (1943) 318 U. S. 80, was a reorganization under the Public Utility Holding Company Act. In that case this Court reversed the action of the Securities and Exchange Commission in denying to officers and directors, who had bought and sold the corporation's stock during the reorganization, the benefit of their trades. This Court said, per Frankfurter, J. (p. 88):

> "As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

And again (pp. 92-3):

> "But before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standards of conduct prescribed by an agency of government authorized to prescribe such standards —either the courts or Congress or an agency to which Congress has delegated its authority. Congress itself did not proscribe the respondents' purchases of preferred stock in Federal. Established judicial doctrines do not condemn these transactions."

The question thus simmers down to one of statutory construction. Did Congress intend to include in §249 officers or employees, such as these, or did it not? The application of the ordinary canons of construction indicates that Congress did not so intend.

A. Weinstein and Fried were not "fiduciaries" of the Debtor within the meaning of §249.

The strictures of §249 fall on "* * * any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, * * *". This is a perfect situation for the application of *noscitur a sociis*. Petitioners recognize this, since they are careful to exclude from their quotation of the section all descriptive words except "person acting in the proceedings in a representative or fiduciary capacity, * * *". [Petition, p. 10.] The maxim is the more applicable since "fiduciary" is a word which may easily take its color from its associates. As was said by Frankfurter, J. in *SEC.* v. *Chenery Corp.* (1943) 318 U. S. 80, 85-6:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To

> whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

The "fiduciary" mentioned in the statute is manifestly of the type that goes with the other appellations used.

It is not disputed that there is no reported case in which the Court has ever applied §249 so as to disallow compensation to any persons other than committee members or lawyers.

B. The Petitioners' argument fails to distinguish between the function of reorganization and the function of carrying on the business of the Debtor.

The person who is to be denied compensation under §249 is a "person acting in the proceedings". This clearly relates to the legal steps leading to a plan of reorganization and not to services performed in a purely ministerial capacity.

With respect to §243, also found in Article XIII, it was said, per Hamilton, C. J. in *Gochenour* v. *Cleveland Terminals Bldg. Co.* (6 C. A. 1944), 142 F. 2d 991, 995:

> "This section of the Act relates entirely to matters in connection with the reorganization of the debtor and proceedings on behalf of creditors and stockholders. It comprehends matters directly affecting the plan of reorganization and excludes those indirectly affecting it."

This proposition is fortified by the fact that Article XIII, in which §249 is found, follows Articles X, XI and XII, which deal solely with the plan of reorganization and with the necessary proceedings if the plan fails.

C. The Bankruptcy Act draws a line between those who are hired and those who seek an allowance.

Weinstein and Fried stand in an entirely different position toward the Debtor from the persons designated in §249. In one case, the relationship is contractual; in the other, there is no contract and compensation depends on benefit to the estate as determined in the Court's discretion.

Weinstein and Fried were performing the same services before the petition for reorganization was filed as they were after. They were hired at fixed salaries and simple contract law would require payment.

Applicants for an allowance stand on an entirely different footing. They have no contractual claim against the Debtor. They stand before the Court seeking its grace, and the Court, subject to appellate review, may in its discretion grant or refuse an allowance. If there has been trading in securities, the Court must disallow it under §249. Apart from §249, the sole test is whether they benefited the estate. In *Dickinson Co.* v. *Cowan* (1940) 309 U. S. 382, the Court said, per Douglas, J. (p. 389):

> "Fee claimants are either officers of the court or fiduciaries, such as members of committees, whose claims for allowance from the estate are based only on service rendered to and benefits received by the estate. Allowance or disallowance involves an exercise of sound discretion by the court based on that statutory standard."

Petitioners picture Weinstein and Fried as applicants for allowances who are privileged to receive their compensation weekly instead of having to wait until the conclusion of the case. This wholly ignores the distinction between those working on contract, on the one hand, and those applying for an allowance, on the other. It would be a quaint

conception that all employees of a debtor-in-possession are merely applicants for allowance subject to §249 and that the weekly stipends that they receive are to be regarded merely as advances.

D. The procedural machinery provided for the enforcement of §249 is wholly inappropriate to a hired employee or to an officer employed on a weekly basis under §191.

§249 requires the applicant for allowance for services or disbursements to "file with the court a statement under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding." Congress surely did not intend that officers of the debtor continued under §191, or employees generally, would file such a verified statement *in court* each week before receiving their pay checks. Some simpler and more practical machinery would most certainly have been devised. Compliance with the section would obviously render it impractical for a debtor-in-possession to employ and keep a staff, or, in fact, to carry on business at all.

E. The harshness of the remedy, which denies all compensation, argues against stretching §249 beyond its setting in Article XIII.

§249, obviously, is a section which easily lends itself to violation by persons in complete ignorance of its existence. Where §249 has been applied within its proper compass the Courts have done so regretfully and almost with apology.*

Judge Dimock *In re Third Avenue Transit Corporation* (S. D. N. Y. 1958), 159 F. Supp. 440, 443, aff'd (1959) 266

* In *Finn v. Childs Co.* (2 C. A. 1950), 181 F. 2d 431, where compensation of committeemen was denied under §249, the Court said, per Clark, Ch. J. (p. 441): "Of course this does not mean that their activity was improper."

F. 2d 862, cert. den. (1959), 361 U. S. 862, said of the application of §249 in that case "This result is nothing short of tragic." "Regret" was the word used by the District Court in rendering its judgment here [F8a].

The Court of Appeals below called the remedy "Draconian" [Appendix B, 55a]. While §249 no doubt serves a useful purpose in the cases for which Congress intended it, there seems little reason why the tragedy should be spread by a forced application.

§249 should not be dragged from its logical relationship to applications for allowance under Article XIII and applied with all its severities to salaries paid for ministerial services provided for under a wholly different article of the Bankruptcy Act.

DETERMINATION OF STOCK INTERESTS IN THE DEBTOR CORPORATION.

[No. 27000]

Statement.

The facts are stated in the opinion of the Court below by Moore, J. [Appendix A to Petition, 33a-47a]. They may be summarized as follows:

The Debtor, a Pennsylvania corporation, was organized August 7, 1951. On September 26, 1951, it acquired title, subject to mortgages, to the fair grounds and farmer's market at Nazareth, Pennsylvania.

The Debtor was authorized to issue two hundred shares of stock. After the filing of the Chapter X Petition on September 28, 1953, the Court ascertained that certificates for 316 shares had found their way into the hands of various persons, none of whom had dealt directly with the corporation.

In accordance with §196 of the Bankruptcy Act (11 U. S. C. A. §596), the District Court directed all claimants to stock interests in the Debtor to file their claims. Pursuant thereto forty-one persons presented their claims to the Bankruptcy Court. After objections had been interposed, extensive hearings were had from which the following facts appeared:

Between March 14, 1951 and March 25, 1953, one Malakoff, who had no assets of his own, received from persons whom he solicited to invest in the market property an aggregate of $145,075. These investors paid their money to Malakoff. None was paid directly to the corporation.

Between June 26, 1951 and February 15, 1952, he paid for the acquisition of the market property, in installments, a total of $58,996. Only about $40,000 of the investors' money is directly traceable from the investors to the purchase price, but Malakoff's collections from the investors always exceeded the installments paid on the purchase price.

On February 2, 1953, Malakoff commenced the delivery of stock certificates. He signed and delivered certificates to the persons who had given him money for investment in the market property, and he also signed and delivered certificates to others in payment of, or as security for, his personal debts arising from transactions not connected with the market property. All the shares issued by Malakoff were purportedly original issue. None of these shares had been paid for or acquired by Malakoff as an individual*.

The Court of Appeals has held that those persons who gave Malakoff money for investment in the market property are entitled to share in the Debtor's capital stock and that those who made no investment, but received certificates in payment of, or as security for Malakoff's personal indebtedness, are not.

Accordingly, the Court of Appeals determined that 33 claimants are to share in the capital stock of the Debtor in proportion to their investments, and that 8 other claimants, who made no investment, are not to share.

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* Before the Debtor acquired title, twenty shares, represented by Certificates Nos. 1 and 2, were issued to the sellers of the property and were then all of the capital stock issued and outstanding. These two certificates, however, after transfer to Malakoff, were eventually surrendered by him to the corporation without the issuance of any certificates in substitution therefor, and, consequently, played no part in the determination of the present stock ownership.

Reasons for Denying Certiorari.

A. Petitioners, being non-investors, are not entitled to share in the capital stock.

Petitioners are among the non-investors. Holding certificates for which they did not pay, they propose, by a legal sleight of hand to establish their claims in equal rank with those who did invest. Their argument is as follows (Petition, pp. 25-28):

The Pennsylvania constitutional provision which forbids the issuance of stocks "except for money, labor done, or money or property actually received" is not self-executing. The corporation's only remedy when shares are not paid for is to assess the shareholders for the subscription price and, if it is not paid, foreclose on the shares pursuant to Purdon's Statutes 15, §2852-605. However, petitioners say, even this dubious remedy is now lost; when the stock claimants filed their claims, the Debtor in each instance counterclaimed for the par value of the shares and these counterclaims have now been dismissed. Thus, they conclude it is now *res judicata* that no one owes the subscription price. Hence, the non-investors are presented with their shares by courtesy of the Bankruptcy Court.

This reasoning not only reaches a fantastic result; it puts the cart before the horse. It is not the Debtor corporation which needs a remedy. These petitioners have filed claims seeking an adjudication that they have an interest in the Debtor's capital stock. Objections having been filed, they have the burden of establishing that they are entitled to such an interest. *Alexander* v. *Theleman* (10 C. A. 1934), 69 F. 2d 610, cert. den. 293 U. S. 581; *Rasmussen* v. *Gresly* (8 C. A. 1935), 77 F. 2d 252; *In re George R. Burrows, Inc.* (2 C. A. 1946), 156 F. 2d 640.

At the threshold, petitioners are met by Purdon's Statutes 15, §2852-603 A, which petitioners contend implements the Pennsylvania constitutional provision. That section provides in part: "Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received".

But even if there were some quirk in the Pennsylvania law which could produce the fantastic result desired by petitioners, it is not Pennsylvania law that is being administered.

It is well settled that in passing upon claims the Bankruptcy Court is not bound by state law, but allows or disallows them upon equitable principles. *American Surety Co.* v. *Sampsell* (1946), 327 U. S. 269; *Heiser* v. *Woodruff* (1946), 327 U. S. 726; *Prudence Realization Corporation* v. *Geist* (1942), 316 U. S. 89; *Pepper* v. *Litton* (1939), 308 U. S. 295. In *In re V-I-D, Inc.* (7 C. A. 1952), 198 F. 2d 392, cert. den. 344 U. S. 914, the Court said (p. 396):

> "As we have shown in the quotations from the Supreme Court decisions cited above, bankruptcy courts were created by Congress for the purpose of administering bankruptcy matters and are governed by federal law. A bankruptcy court does not sit 'as another state court' and is not governed by state laws."

And in *Vanston Committee* v. *Green* (1946), 329 U. S. 156, the Court said by Black, J. (p. 162):

> "In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. *Erie R. R.* v. *Tompkins*, 304 U. S. 64, has no such implication. That case decided that a federal district court acquiring jurisdiction because of diversity of citizenship should adjudicate contro-

versies as if it were only another state court. See *Holmberg* v. *Armbrecht*, 327 U. S. 392. But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles."

In consonance with the above Supreme Court decisions, the Court of Appeals for the Sixth Circuit in *In re American Fuel & Power Co.* (1941) 122 F. 2d 223, appeal dismissed 322 U. S. 379, rejected a claim for stock interests in a debtor corporation, saying (p. 229):

> "In view of the remedial purpose of the provisions of the Bankruptcy Reorganization Act enlarging the category of provable claims, the statute is liberally construed in favor of claimants for whom relief was intended. Its object was to facilitate rehabilitation of embarrassed corporations by disallowing illegal or unconscionable stock interests or claims and by scaling or rearranging their obligations and shareholders' interests, thus avoiding a winding up, a sale of assets and distribution of the proceeds. City Bank Farmers Trust Company v. Irving Trust Company, 299 U. S. 433, 437, 57 S. Ct. 292, 81 L. Ed. 324. Under the Bankruptcy Act, the test of the provability of claims of creditors or the interests of stockholders is the actual existence of valid claims or interests. In re United Cigar Stores Company of America, 2 Cir., 83 F. 2d 202, affirmed by the Supreme Court in Meadows v. Irving Trust Company, Trustee, 299 U. S. 464, 57 S. Ct. 307, 81 L. Ed. 353.
>
> "The claim of a creditor or the interest of a stockholder which is invalid because it is based on or arises out of an illegal or criminal transaction, is not provable or allowable in bankruptcy reorganizations. [Citations omitted.]".

B. Allowance of the claims of those who invested after the completion of payments for the market property was proper.

Petitioners argue [Petition, p. 29] that the Court below could not properly set up a trust of the market property for the benefit of those investors who gave their money to Malakoff after the completion of the payments for the property by Malakoff on February 15, 1952. The status of these later investors, however, is entirely different from that of petitioners. They made a contribution intended for the venture, while the non-investors, including petitioners, made no contribution and did not intend to make any. If a traditional equitable ground of relief is necessary to support the stock claims of these later investors it is found in the principle of estoppel. The Debtor is estopped to deny them, since Malakoff was its president and thus authorized to represent it in receiving their payments. Resort to this basis of equitable relief, it may be noted, would be in accordance with Pennsylvania law. *Appeal of Kisterbock* (1889) 127 Pa. 601, 18 A. 381; *Krall* v. *Lebanon Valley Savings & Loan Association* (1923) 277 Pa. 440, 121 A. 405. The principle is also recognized in New York. *New York & New Haven R. R. Co.* v. *Schuyler* (1865) 34 N. Y. 30.

However, whatever law is applied, and whether the equitable principle is resulting trust, constructive trust or estoppel, the result achieved by the Court of Appeals in awarding the Debtor's stock to those who invested, and denying stock to petitioners who made no contribution, and had no intention of making any, is both equitable and just.

Conclusion.

The petition for Writs of Certiorari should be denied.

Dated: New York, N. Y.,
March 14, 1962.

Respectfully submitted,

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